

Instalment Warrants & SMSFs

- ❖ Instalment warrant purchases of “acquirable assets” are an exception to the general borrowing prohibition for SMSFs
- ❖ Acquirable assets include real estate, units/shares in an ungeared property holding unit trust/company, listed securities in a single company & a work of art
- ❖ Each instalment warrant contract must be limited to a single asset or a collection of identical assets
- ❖ Purchase subject to investment strategy & *SIS Act* rules
- ❖ Instalment warrant parties include **SMSF trustee** (as ultimate purchaser), (limited recourse) **lender** & **custodian trustee** (holding asset for duration of instalment payments)

Instalment Warrants – 2 Key Components

There are 2 key components for an instalment warrant that meets the requirements of ss67(4A) of the *Superannuation Industry (Supervision) Act 1993* (“the *SIS Act*”) being used to partly fund the trustee of an SMSF or other Australian superannuation fund purchasing real estate or other permitted assets for the fund, ie:

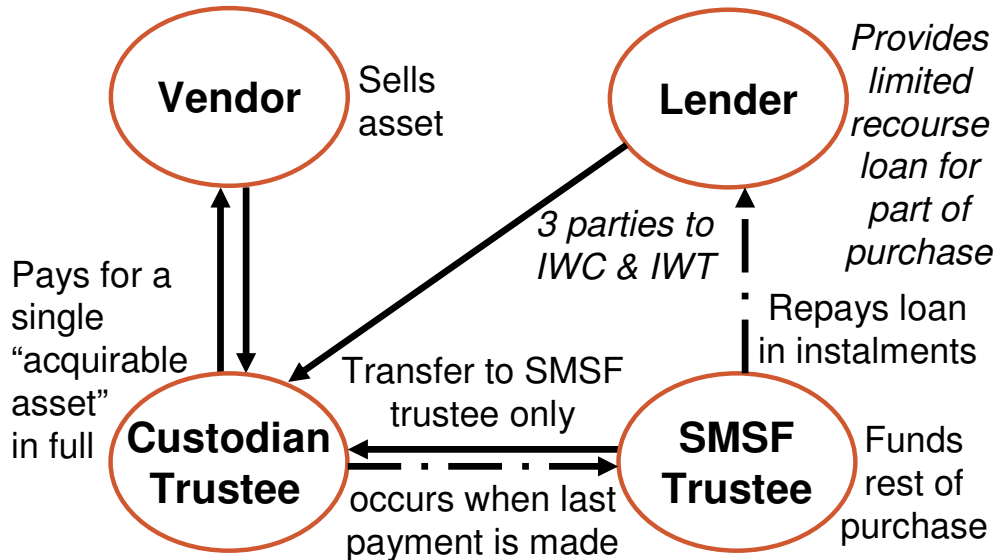
1. An instalment warrant contract (“IWC”). The obligations under this contract are concluded either once all of the instalment payments have been made or if the asset subject to the instalment warrant is sold and the sale proceeds have been distributed proportionately between the lender and the trustee of the fund.
2. An instalment warrant trust (“IWT”) appointing a custodian trustee to hold the asset being acquired for as long as the asset is subject to the terms of an IWC.

If the requirements of ss67A and 67B are not met, the general prohibition against borrowing provisions in s67 of the Act would apply instead and the SMSF or other superannuation fund would be in breach of the *SIS Act* and in danger of losing its income tax concessions.

Instalment Warrants – 3 Funding Options for SMSFs

1. A limited recourse loan (ie the lender can only recover against the asset) is made by a bank (or finance company) for part of the funds needed to acquire the asset, as banks are loathe to make limited recourse loans to the current value of the asset, the balance of the acquisition price will need to come from the trustee of the externally managed fund or a self superannuation fund (“SMSF”).
2. A limited recourse loan is made by a party associated with the trustee of an SMSF with that loan in turn being wholly or partly funded by a full recourse loan from a bank.
3. A limited recourse loan is made by a party associated with the trustee of an SMSF (that party having contribution limit, Division 7A or need for liquidity issues) with no bank or other 3rd party finance.

Instalment Warrant Contract & Trust



Subsection 67A(1) – Limited Recourse Borrowing Exception

"... (a) the money is or has been applied for the acquisition of a single acquirable asset, including:

(i) expenses incurred in connection with the borrowing or acquisition, or in maintaining or repairing the acquirable asset (but not expenses incurred in improving the acquirable asset); and

(ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and

(b) the acquirable asset is held on trust so that the RSF trustee acquires a beneficial interest in the acquirable asset; and

(c) the RSF trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest; and

(d) the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) default on:

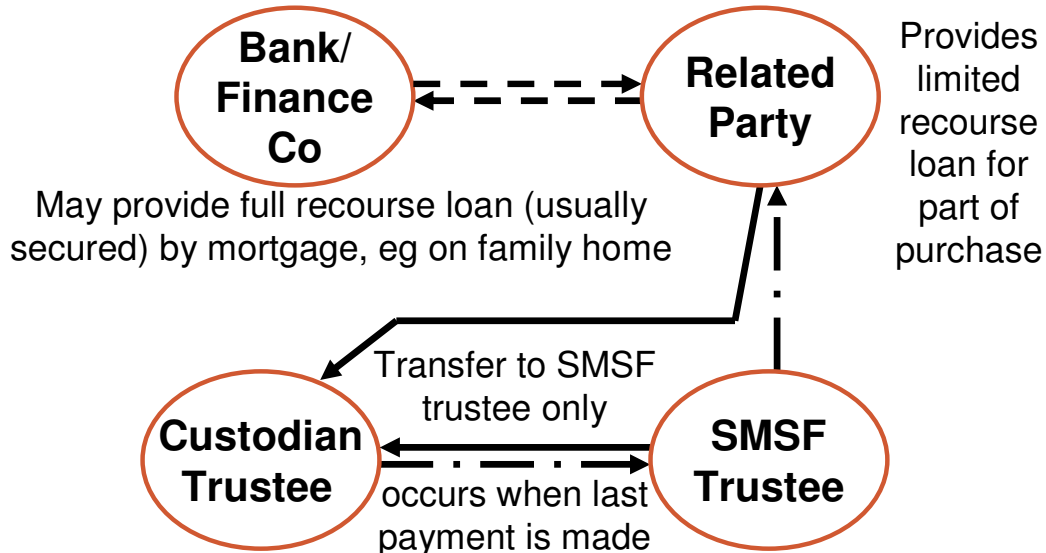
(i) the borrowing; or

(ii) the sum of the borrowing and charges related to the borrowing; are limited to rights relating to the acquirable asset; and

(e) if, under the arrangement, the RSF trustee has a right relating to the acquirable asset (other than a right described in paragraph (c)) - the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the acquirable asset; and

(f) the acquirable asset is not subject to any charge (including a mortgage, lien or other encumbrance) except as provided for in paragraph (d) or (e)."

Related Party Lending



Instalment Warrants – Documentation

The 2 documents needed for a ss67A instalment warrant are an IWC and an IWT:

1. The IWC sets out the terms of purchase, number of instalment payments, amounts to be paid, rights of the parties and the completion of the contract, ie either by the completion of the instalment payments or the sale of the asset by the custodian trustee.
2. The IWT sets out the appointment of the custodian trustee, the responsibilities of the trustee and the rights and obligations of the beneficiary SMSF. If the lender agrees, the custodian trustee is a person or entity associated with the members of the SMSF, but not the lender or the trustee (or a trustee) of the SMSF. Alternatively the lender may insist on their own choice of trustee, which may create additional costs.

As the SMSF is subject to annual audits, the firm preparing the documentation will usually also provide a letter regarding compliance of the ss67A requirements.

Instalment Warrants – Associated Documentation

Other documents that may need to be prepared include:

1. A new company may need to be established to act as the custodian trustee.
2. The SMSF itself may need to be established (a new company may also be required to act as trustee of the SMSF).
3. The governing trust Deed for an existing SMSF may need to be updated, eg to amend the borrowing restrictions to permit the use of an instalment warrant.
4. If the lender is the trustee of a trust, the powers in the trust Deed may need updating.
5. Conveyancing documents for the purchase of real estate (and possibly the related party sale as well) or transfer documents for other assets such as units and shares.
6. If the asset purchased is real estate, the lease agreement between the tenant and the SMSF trustee for the lease of the property (if the parties to the lease are related, the terms of the lease should be commercially realistic).

Instalment Warrants & SMSFs – Further Reading

Australian Master Estate Planning & Succession Guide – Chapter 3

The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/epss/pocket-summaries

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Further Reading

- The 1st edition of the **Australian Master Estate Planning and Succession Guide** by Allan Swan is scheduled to be published by **CCH** in 2011.
- The 1st edition of **You Can't Take It With You** by Andrew Simpson was published by **Wrightbooks** in 2009.
- The 5th edition of **Tax Issues in Family Law Property Settlements** – The Difference Between Hacking and Carving by Peter Szabo was published by **MOORESLEGAL** in 2008.

About the Author of the Pocket Summaries – Allan Swan

In addition to his main role as a principal of the **MOORESLEGAL** estate planning team (working in the areas of **Asset Protection, Trusts, Superannuation, Tax and Estate Planning**) Allan is also the principal of **APTSTEP**, a provider of training and materials. Allan's current presentation topics are:

- Asset Protection Planning
- Blended Families
- Business Structures Overview (includes page 2 of this Pocket Summary)
- Estate Planning – Key Cases and Rulings
- Estate Planning – Practical Case Studies for 2010
- Estate Planning – Tax and Strategic Issues (2)
- Funding Estate Planning
- Ruling from the Grave
- SMSFs – Planning Issues (all)
- Superannuation Death Benefits (2 & 3)
- Superannuation Overview (all)
- Testamentary Trusts
- Trusts – Income and Capital Distributions
- Trusts – The A-Z.

Contact Allan on 03 9843 2153 for further information regarding on the content of the topics, the fees charged and to schedule a presentation, workshop or seminar.